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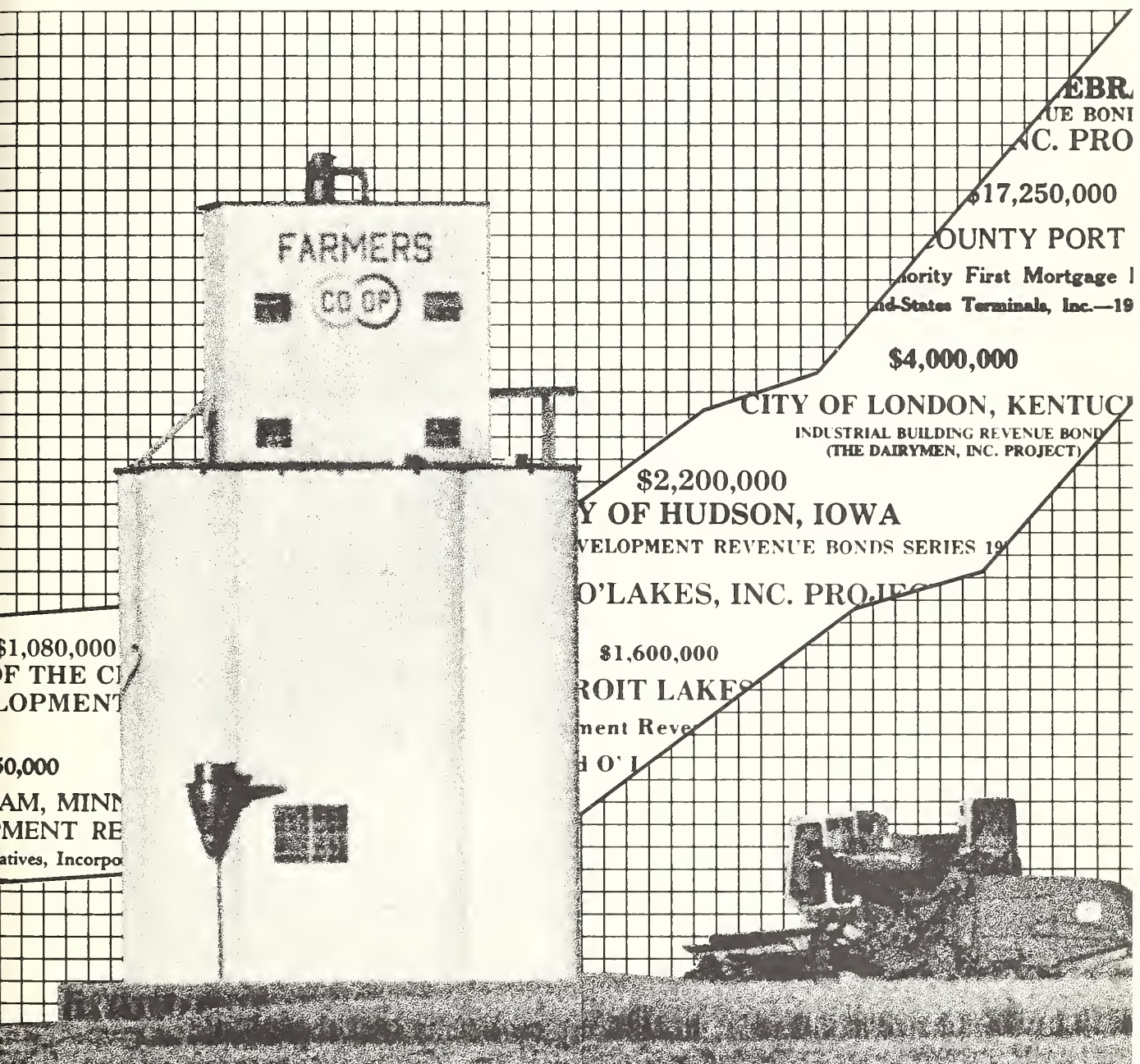
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Industrial Development Bond Financing for Farmer Cooperatives

Donald R. Davidson



INDUSTRIAL DEVELOPMENT BOND FINANCING FOR FARMER COOPERATIVES. By Donald R. Davidson; Cooperative Management Division; Economics, Statistics, and Cooperatives Service; U.S. Department of Agriculture. Farmer Cooperative Research Report No. 18

ABSTRACT

A nationwide survey of 7,535 farmer cooperatives shows both large and small cooperatives—locals, regionals, and interregionals—in 24 States using industrial development (ID) bonds for long-term debt financing to construct or expand grain elevators, pollution control facilities, feed mills, fertilizer plants, fluid milk plants, and warehouses. As of June 1979, 52 cooperatives had 130 projects financed with ID bonds totaling \$265 million, with a median of \$1 million per project. Although ID bonds originated in Mississippi in 1936, major co-op use of these tax-exempt bonds occurred after 1975, when 62 percent of all such co-op ID bond-financed projects originated.

Key words: Industrial development bonds, Long-term financing, Cooperatives, Industrial revenue bonds, Tax-exempt financing, BAWI bonds, Leasing

NOTICE

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FOREWORD

The financing of producer-owned businesses has been a traditional and major concern to members, managers, and boards of directors of cooperatives. The Nation's farmer cooperatives, over the years, have forged unique financing tools. Only in the cooperative field does one hear the terms "per-unit capital retain," "patronage refund," "net savings," and "equity redemption." But, cooperatives have not hesitated to use the most modern financing practices of corporations and other private concerns when these financing tools have been available and applicable to the cooperative way of doing business.

The basis of successful financing for farmer cooperatives is equity capital furnished by member-patrons. Next, Banks for Cooperatives provide the major source of borrowed funds. Then, cooperatives often issue their own debt and/or equity paper, or turn to other lending

institutions such as commercial banks and insurance companies. However, many of today's cooperatives often need additional sources of long-term, low-cost debt capital. A type that offers new opportunities is the industrial development (ID) bond, often called industrial revenue bonds. First authorized in Mississippi to Balance Agriculture With Industry (and called BAWI bonds), today's industrial development bonds are a financing tool used increasingly by all types and sizes of farmer cooperatives.

This report can assist cooperatives which are contemplating use of industrial development bonds as a method of long-term financing. It shows the extent to which cooperative ID bond financing is already in use, how such co-ops have fared in their use of ID bonds, and why ID bond financing might be beneficial to many cooperatives not familiar with this type of financing.

J. Warren Mather, Director
Cooperative Management Division
Economics, Statistics, and
Cooperatives Service

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SUMMARY

Industrial development (ID) bonds are used by businesses for long-term financing in more than 40 States and the District of Columbia. They originated in Mississippi in 1936. This study found that only three farmer co-ops had used ID bonds before 1960. Many farmer-owned organizations have now turned to this financing method for their long-term debt needs. By June 1979, 52 co-ops reported 130 ID bond-financed projects in 24 States. The majority of these projects originated after 1975.

The 130 co-op projects financed with proceeds from ID bond issues totaled \$265 million, with a median amount per project of \$1 million. The 52 co-op ID bond users represented less than 1 percent of all co-ops in the country, but they accounted for \$18 billion or 31 percent of total co-op sales in 1978.

All farmer co-ops are potential users of ID bonds. Co-ops as small as \$1.2 million in annual revenues and as large as \$3.2 billion used ID bonds. The 52 co-ops consisted of 23 locals, 24 regionals, and 5 interregionals of various sizes and types of operation. Most of the locals and regionals were in the North Central area. Membership in the regionals was fairly evenly distributed among centralized, federated, and mixed memberships.

Regional co-ops averaged four projects each, compared with one project per local.

Thus, the regionals accounted for 74 percent or 96 of the 130 ID bond-financed projects. Sometimes they used more than one bond issue per project because of later expansion or improvements.

Farmer co-ops have used ID bond issues to construct or expand grain elevators, pollution control facilities, feed mills, fertilizer plants, fluid milk manufacturing plants, warehouses, soybean and/or seed-corn processing plants, poultry and/or egg facilities, peanut and pecan shelling plants, and vegetable processing plants and to acquire land and office buildings (these projects are listed in descending order of dollar volume of ID bond financing).

Interest income on ID bonds that meet requirements set forth in Section 103(c) of the Internal Revenue Code is excludable from gross income for Federal income tax purposes. Such interest is also generally exempt from income taxes of the State in which ID bonds are issued.

Length of maturity of local co-op bond issues ranged from 6 to 20 years, with an average of 13 years. The rate of interest varied from 8.5 percent to 5.5, averaging 7 percent. Length of maturity of the 113 issues used by regionals ranged from 7 to 30 years, with an average of 15. The interest rate varied from 8.4 to 1.8 percent, with an average of 6.2.

Industrial Development Bond Financing For Farmer Cooperatives

Donald R. Davidson
Agricultural Economist

INTRODUCTION

Industrial development (ID) bonds are being used more extensively by farmer cooperatives as a source of long-term debt capital. Only three farmer-owned organizations in two Southern States had financed projects with ID bonds before 1960. By June 1979, more than 50 associations located in 24 States were using this source of funds to finance property, plant, and equipment.

This study reports the extent of ID bond financing used by farmer-owned business organizations. It indicates the extent that cooperatives use this type of capital, for what purposes it is used, and the basic properties and potential of ID bonds as a source of funds for farmer-owned marketing and supply associations.

Any cooperative needing long-term financing for new buildings or expanding plant facilities and equipment, or for acquiring such fixed assets is a potential user of ID bonds. Local cooperatives as well as regional and interregional associations are drawing on this source of capital. Cooperatives as small as \$1 million in sales and as large as \$3 billion have used them.

ID bond financing began in Mississippi in 1936 (10, p. 1; 15, p. 10; 8, p. 2).¹ To fight unemployment and poverty, the State authorized its local governments—cities and counties—to issue bonds that would encourage indus-

trial development. Mississippi's "Balance Agriculture With Industry Act" resulted in the first U.S. issue of ID bonds. They were called BAWI bonds. They were general obligation-type² bonds amounting to \$85,000 and were used to finance the building of a factory for leasing to a private concern.

Another BAWI bond issue helped create the South's largest fertilizer maker. Yazoo County, Miss., issued ID bonds in 1949 to help finance a nitrogen plant a group of farmers wanted to build. That was the beginning of Mississippi Chemical Corporation, which is one of the Nation's largest and most successful farmer cooperatives.

Kentucky passed an ID bond statute in 1948. By 1960, 14 States had such provisions. Today, over 40 States and the District of Columbia have authorized in some form the issuance of ID bonds (1, p. 54; 14, p. 28).

Mississippi still leads all other States in the dollar amount of ID bonds issued to finance projects of cooperatives. Minnesota is second, although its cooperatives did not start using ID bond financing until 1973. It was not until the seventies that this method of financing was used to any large extent by cooperatives outside the South.

²General obligation-type ID bonds are municipal obligations backed by the full faith and credit of the State or local entity and secured by the taxing power of the issuing government.

¹Underscored numbers in parentheses refer to items listed in Literature Cited.

OBJECTIVES AND PROCEDURES

The author personally interviewed management officials of nine large farmer cooperatives in the initial phase of this study. Purpose of

these visits was to (1) obtain indepth and detailed information on these cooperatives' experiences with ID bond financing for a preliminary

report and (2) refine and pretest a mail questionnaire for a nationwide survey of cooperatives with projects financed wholly or partially with proceeds from ID bond issues. Results of that survey were reported in (5 and 6).

This report represents the second phase of the ESCS study. More specific objectives were to find answers to such questions as:

- What is the type, location, and size of cooperatives using ID bond financing and for what purposes?

- How many projects have cooperatives financed with ID bonds? What was the size of each issue and type of political subdivision (city, county, industrial development corporation, etc.) issuing bonds?

- Why do cooperatives select ID bonds in lieu of other sources of financing such as Banks for Cooperatives, other lending institutions, or issuance of own securities?

- What requirements or qualities are necessary for a cooperative to obtain this type of financing? Must it be a certain type or size, have a strong balance sheet, be able to justify the project's feasibility in terms of probable margins to be generated, create new jobs?

- Have municipalities, counties, or communities offered any incentives to cooperatives to get them to use ID bonds in financing a local facility, such as donation of plant site or exemption from payment of real property taxes?

- What sources of assistance have cooperatives used in obtaining ID bond financing such as State and local development authorities, investment bankers (underwriters), bond counsel, or other cooperatives?

- What do cooperative officials feel are the major advantages and disadvantages of financing projects with ID bonds as compared to other sources of long-term debt capital?

A single-question screener form was sent to a 75-percent sample of the 7,535 farmer-owned associations operating in the United States to determine the extent that cooperatives use ID bond financing (12, p. 19). (See app. table 1.) More than 87 percent responded to the screener survey. The 4,950 respondents thus represented 66 percent of the Nation's 7,535 farmer cooperatives. Only 52 of the 4,950 respondents indicated that they had any projects financed with ID bonds.

A mail questionnaire was sent to these 52 cooperatives to obtain specific information on (1) number and types of projects financed; (2) date, size, interest rate, and length of maturity of ID bond issues; (3) name and location of municipal issuers; (4) reasons for selecting ID bonds; (5) problems in issuing and placing ID bonds; and (6) benefits and drawbacks of this method of funding.

This report is aimed primarily at the large number of farmer-owned businesses not using—or unaware of—this source of long-term debt capital. It will help cooperative managers and directors weigh the merits of this type of financing with other methods of funding. The report should also help State and local development authorities responsible for approving and controlling ID bond issues, municipal officials interested in issuing ID bonds for financing cooperative projects, other people interested in the cooperative way of doing business, and State and Federal researchers concerned with cooperative problems and agricultural finance.

CHARACTERISTICS OF ID BOND COOPERATIVES

The 52 farmer cooperatives reporting projects financed by issuance of ID bonds run the gamut in size, membership structure, and type of operations. Nearly as many local associations as regional cooperatives have used ID bonds (table 1).

Local Cooperatives

Twenty of the 23 locals with projects financed with ID bonds were located in seven

North Central States (table 2). Two were in Colorado and one was in Oklahoma. Eighteen of them engaged primarily in marketing members' products (table 1). The locals had a centralized membership structure. Because they serve a local area, community, or one or more counties—and deal directly with farmers—their membership is composed strictly of individual farm operators. The 1978 sales volume of the 23 locals ranged from \$1.2 million to \$87 million, with a median of \$8 million (table 3).

Table 1—Type and membership structure of the 52 farmer cooperatives using ID bonds, June 1979

Type of cooperative	Membership structure			Total
	Centralized ⁴	Federated ⁵	Mixed ⁶	
	Number			
Local: ¹				
Grain	12	0	0	12
Dairy	6	0	0	6
Farm supply	5	0	0	5
Subtotal	23	0	0	23
Regional: ²				
Diversified	0	2	5	7
Dairy	4	1	1	6
Farm supply	0	3	2	5
Grain	0	1	1	2
Sugar	2	0	0	2
Fruit and vegetable	0	0	1	1
Poultry	1	0	0	1
Subtotal	7	7	10	24
Interregional: ³				
Farm supply	0	3	0	3
Grain	0	2	0	2
Subtotal	0	5	0	5
Total	30	12	10	52

¹Provides cooperative services in a local area or community, a county, or several counties. Individual farmers are its members. It may or may not be affiliated with a regional or other co-ops.

²Serves a district consisting of a number of counties, or, in some cases, a number of States. Regionals include all federated co-ops—centralized associations serving more than 8 or 10 counties—and co-ops with large volumes that are neither strictly federated nor strictly centralized.

³One whose members are regional cooperatives and is owned and controlled by these organizations.

⁴Individual farmers make up the membership.

⁵Membership composed of 2 or more local, regional, or interregional associations.

⁶Have both individual farmers and co-ops as members.

Table 2—Location of the 52 local, regional, and interregional farmer cooperatives using ID bonds, June 1979

Region and State	Locals	Regionals Number	Interregionals
Middle Atlantic:			
New York	0	1	0
Mountain:			
Colorado	2	0	0
North Central:			
Illinois	0	1	1
Indiana	0	1	0
Iowa	3	2	0
Kansas	1	0	2
Minnesota	5	6	1
Missouri	0	1	0
Nebraska	1	0	0
North Dakota	2	0	0
Ohio	0	1	1
South Dakota	2	0	0
Wisconsin	6	2	0
South Atlantic:			
Virginia	0	3	0
South Central:			
Alabama	0	1	0
Georgia	0	1	0
Kentucky	0	1	0
Mississippi	0	2	0
Oklahoma	1	0	0
Pacific:			
California	0	1	0
Total	23	24	5

Over 90 percent of all cooperatives, including these 23 locals, have gross sales under \$10 million and 81 percent have under \$5 million (app. table 2). This is based on 1976 business volume data for 7,535 cooperatives. The six dairy locals were by far the largest among the 23. They accounted for nearly two-thirds of the local associations' 1978 sales volume (table 3).

Regional Cooperatives

Most of the regionals using ID bond financing were located in seven North Central States (table 2). Minnesota, Wisconsin, and Iowa had the largest number of local and regional cooperatives. Only one local with some ID bond financed assets was situated in the South, but eight regionals using ID bonds were headquartered there.

Membership of the regionals was fairly evenly distributed among centralized, federated, and mixed types of membership (table 1). The 7 regional federations (with other cooperatives as members) had the largest 1978 median sales—amounting to \$608 million—compared to the 10 mixed and 7 centralized associations with median revenues of \$486 million and \$152 million, respectively. (Data on sales and revenues taken from cooperative annual reports.)

All of the centralized regionals were marketing cooperatives. The seven diversified regionals were engaged extensively in both marketing and farm supply operations. The diversified regionals represented the largest group in terms of median sales among the 52 cooperatives reporting ID bond financed projects (table 3). Only about 1.1 percent of the 7,535 co-ops in the United States have annual sales of \$100 million and over; the seven diversified co-ops were in this group (app. table 2).

Interregional Cooperatives

Regional cooperatives form the membership of an interregional cooperative. Federated cooperatives may be regarded as regional or interregional associations depending on whether they have mainly local or regional members. Three of the five interregionals using ID bonds were farm supply concerns (table 3).

Some of the interregionals had regional

members surpassing them in sales volume. For example, one grain marketing interregional with 1978 revenues of \$243 million had four regional member cooperatives, two of which had 1978 sales exceeding \$600 million each. The other interregional grain cooperative using ID bond financing had 1978 sales of \$1.4 billion and nine member cooperatives. One of these members is the largest U.S. farmer cooperative with 1978 revenues of \$3.2 billion. Seven of its nine members were regional cooperatives with six of them federations and one a mixed association serving 541 local cooperatives and 80,000 farmers directly. The other two members are interregional grain cooperatives, owned by five regional associations in one case and two in the other.

One of the three farm supply interregionals (table 3), with 1978 sales of \$671 million, manufactures, distributes, and transports fertilizer and explores for raw materials. Its chemical plant food materials are sold primarily to its 19 regional farm supply member-owners in the United States and Canada.

Another of the farm supply interregionals cited in table 3 is a petroleum cooperative with 1978 sales of \$309 million. It is owned by six regional cooperatives which market the interregional's refined fuels through affiliated local cooperatives throughout the North Central States.

The other farm supply interregional, with 1978 sales of \$243 million, is owned by 38 regional cooperatives in the United States and Canada. It purchases and manufactures a wide variety of products for resale to its members, including animal care equipment, tires, batteries, and accessories. All five of the interregionals are located in the North Central States (table 2).

Significance of the 52

The 52 cooperatives using ID bonds represent only about 1 percent of the total 7,535 cooperatives operating in the United States. But, they represent nearly 31 percent of the total sales of all cooperatives, with \$18.2 billion in 1978 sales (table 3).

Sales for the 52 co-ops in 1978 ranged from \$1.2 million (a local grain association) to \$3.2 billion (a regional diversified cooperative), with a median sales level of \$75 million (table 3). Ten

Table 3—Total and median sales volume of the different types of farmer cooperatives using ID bonds, fiscal years ending in 1978

Type of cooperative	Cooperatives	1978 sales volume	
		Total	Median
	Number	Million dollars	
Local: ¹			
Grain	12	89.1	6.4
Dairy	6	227.0	27.5
Farm supply	5	25.2	3.5
Subtotal	23	341.3	8.0
Regional: ¹			
Diversified	7	8,952.7	1,290.0
Dairy	6	1,159.1	116.0
Farm supply	5	2,188.9	404.0
Grain	2	1,735.0	867.5
Sugar	2	345.0	172.5
Fruit and vegetable	1	592.0	592.0
Poultry	1	56.0	56.0
Subtotal	24	15,028.7	391.5
Interregional: ¹			
Farm supply	3	1,246.2	309.1
Grain	2	1,635.1	817.6
Subtotal	5	2,881.3	309.1
Total	52	² 18,251.3	75.0

¹See footnotes 1, 2 and 3, table 1.

²Total sales of the 52 co-ops (which include several of the largest U.S. co-ops) were \$1.5 billion less than General Electric's \$19.7 billion of sales for 1978. GE ranked eighth in Fortune's list of 500 largest industrial corporations.

of the 52 cooperatives are among the 15 cooperatives included in *Fortune* magazine's 1979 list of the 1,000 largest industrial corporations in the United States (16, pp. 270-288). Of the 10

ID bond cooperatives using ID bonds in the *Fortune* list, eight are among the 24 regionals and two are included in the five interregional federations shown in tables 1 and 3.

NATURE OF ID BONDS

Of the 150 issues that local government units made to finance cooperative projects (table 4), 138 (92 percent) were ID revenue bonds. The other 12 issues were ID general obligation bonds. Six of the seven issues made prior to 1960 were general obligation ID bonds used by two Mississippi-based cooperatives. Three of the seven issues made during 1960-64 were also ID general obligation bonds used by southern cooperatives. The other three issues were made in the South during the early seventies.

Only two of the 52 cooperatives with ID-bond financed projects have used general obligation-type issues and in recent years they too have turned to the revenue-type obligation. More than 40 States have statutes encouraging ID bond financing. Furthermore, 16 of these also have statutes enabling cooperatives and other businesses to use general obligation ID bonds (14, p. 28).

The distinction between general obligation and revenue bonds indicates how the ID bonds are secured. Revenue ID bonds are municipal obligations drawing principal and interest payments from revenues of the project itself. They are secured only by the property acquired with the proceeds of the bond sale and the income the property produces under terms of the lease con-

tract, loan agreement, or sales transaction. General obligation ID bonds may also be secured by a pledge of revenues from, and a mortgage on, the project. But the big difference is that if the user of the project fails to make principal and interest payments on the bonds, the local government issuer will assume this responsibility. Thus, ID general obligation bonds are backed by the full faith and credit of the State or local entity and secured by the taxing power of the issuing government (9, p. 148; 5, p. 6; 1, p. 37).

ID Bonds Defined

ID bonds may be described as long-term obligations issued by a local government unit (municipality, county, city, industrial development authority) to finance the purchase, construction, improvement, or expansion of property, plant, and equipment to be leased or sold to private enterprise, or to lend proceeds to private enterprise for these purposes (5, p. 4; 6, p. 3; 11, p. 335).

The enabling statutes of more than 40 States show similar objectives for this type of financing. Purposes most frequently cited are to:

Table 4—Number of farmer cooperatives initiating projects entirely or partially financed with ID bond issues and their combined amounts

Period	Cooperatives	Projects	ID bond issues	Amount
		Number		1,000 dollars
Before 1960	3	4	7	2,775
1960-64	4	6	7	9,785
1965-69	7	11	14	17,027
1970-74	17	29	32	36,408
1975-79 ¹	42	80	90	199,085
Total		130	² 150	265,080

¹Data for 1979 do not extend beyond June.

²Exceeds number of projects because several cooperatives financed a given project with more than one issue.

— Secure and develop industry within or near the municipality or in the county.

— Induce industrial, manufacturing, and agricultural enterprises to locate or remain in the State.

— Provide enlarged opportunities for employment and create and preserve jobs.

— Promote use of agricultural products and protect natural resources.

— Improve living conditions and reduce, abate, and prevent environmental pollution.

— Prevent emergence of blighted and marginal lands.

— Foster a sound and proper balance in the State between agriculture, commerce, and industry.

— Stimulate prosperity, improve economic welfare, and increase the State's tax base.

— Assist and retain local industry, compete for new industry, and strengthen and revitalize the economy.

ID bonds are basically debt instruments, the proceeds of which are to be used in the trade or business of anyone who is *not* an exempt person, and payment of which is secured by property used in the trade or business or by payments generated by revenues obtained from such property (Section 103(c) of the Internal Revenue Code of 1954). Exempt persons are governmental units and exempt organizations described in Section 501(c)(3) of the code such as corporations, and any community chest fund, or foundation, organized and operated for religious, charitable, literary, or educational purposes (3, p. 381; 4, p. 569).

Section 103 of the code provides certain key points in indicating how ID bonds may be used in a trade or business of a nonexempt person, such as a farmer cooperative. Bond proceeds may be used for the acquisition, construction, reconstruction, or improvement of land, property, or fixed assets of the kind subject to depreciation. This implies that such proceeds cannot be used for the financing of working capital or current asset items, including the purchase of inventories or the incurring of receivables.

Interest income on ID bonds that meet the requirements set forth in Section 103(c) of the code is excludable from gross income for Federal

income tax purposes. As a general rule, such interest is also exempt from income taxes of the State in which the ID bonds are issued. States normally do tax interest on ID bonds issued by political subdivisions of other States.

In some cases, however, States do *not* tax either their own or other States' ID bonds regardless of whether the bonds are held by individuals or corporations. But, a few States tax interest received on ID bonds whether issued within or out of State boundaries and without regard to who holds them (14, p. 30).

Growth in Size of Bonds

ID bonds had become quite popular among businesses outside the cooperative community by the late sixties and size of bond issues had expanded rapidly. Only 28 ID bond issues had been made to finance cooperative projects prior to 1970 (table 4). The seven issues made before 1960 averaged \$396,000 compared to an average of \$1.4 million for the seven floated between 1960-64. The 14 issues marketed in 1965-69 dropped to an average \$1.2 million.

Altogether, an estimated 1,232 ID bond issues were made in the United States from 1936 through 1968. Their average size increased rapidly from \$430,000 in the fifties to \$1.2 million in 1961 and reached \$9.3 million by 1968 (2, p. 8). Congress put a limit on the size of ID bonds that could qualify as tax-exempt issues in 1968 because Congressional members believed that such funding was being misused by several large companies to finance big projects not necessarily related to the industrial development of municipalities.

Tax-exempt Issues

Interest on ID bonds was excludable from gross income of bondholders for Federal income tax purposes from January 1969 to December 1978, provided the issue was not above \$1 million under certain conditions, or \$5 million if other requirements were met. The Revenue Act of 1978 raised the \$5-million limitation to \$10 million for ID bonds issued on or after January 1, 1979. This action by Congress in restricting the size of issue, referred to as the small-issue exemption, reversed the upward trend in size of ID bond issues for businesses in general. However, cooperatives reported their biggest use of ID bonds after 1969 as table 4 makes clear.

Besides qualifying as exempt small issues, ID bonds may also be used to finance certain other exempt activities spelled out in Section 103 of the code and may be of any size. These include the financing of air or water pollution control facilities, sewage or solid waste disposal facilities, grain storage facilities, docks, wharfs, and airports. The most important type of project cooperatives have used ID bonds for (based on dollar amount of such financing) was to finance grain elevator construction or expansion. The second most important was to finance pollution control facilities.

The limitation increase to \$10 million made possible by the Revenue Act of 1978 should make ID bonds even more attractive to regional and interregional cooperatives and to the larger local associations. Because of rapidly increasing costs associated with plant construction and equipment purchases, the higher \$10-million ceiling should make it possible for many cooperatives to finance a broader range of projects under the small-issue exemption.

\$1-million and \$5-million Limitations

None of the 23 local associations among the 52 cooperatives studied were limited by the \$1-million or \$5-million restriction on size of issue (table 5). (The \$10-million ceiling was not yet effective when this question was posed.) The locals had used ID bonds to finance 24 projects by June 1979, with the average (median) size issue amounting to \$673,000.

For the other 29 cooperatives, made up of 24 regionals and 5 interregionals, restrictions on

size of issue was often a problem. Eleven of the 24 regionals indicated limitations on size of issue did *not* affect their use of ID bonds but 13 answered otherwise (table 5). An official of one of these regionals using the proceeds from a \$4-million issue to finance a milk processing plant mentioned, however, that the co-op: "Must monitor its capitalization expenditures very carefully to ensure full compliance with the \$5 million limitation." Another one of the 11 using a \$5.6-million issue to finance a waste water treatment facility was not affected by the \$5-million limitation because this was an ID bond exempt activity with no restrictions on size of issue.

The 13 regionals indicating the \$1-million and \$5-million size restrictions on exempt small issues of ID bonds had limited their use of this type of financing were among the largest cooperatives in the United States. Their projects accounted for 98 of the 150 issues made to finance projects of the 52 cooperatives. Nine of the 13 regionals indicated limitations on size of issue had caused them to use ID bonds as only a partial source of financing in covering total cost of a project; nine also said it had restricted the type of project that could be financed (table 5).

Two of the five interregional users of ID bonds indicated that the \$1-million and \$5-million size limitation did not restrict their use of this type of financing (table 5). These two were grain marketing interregionals: one that had used ID bonds to acquire port facilities (public grain elevators) and the other to construct them, with issues amounting to \$26 million and \$17.2 million, respectively. These two issues—one

Table 5—How the \$1-million and \$5-million-or-less limitations on size of issue affected cooperatives using ID bond financing¹

Effect	Locals ²	Regionals ²	Interregionals ²
		Number	
Did not limit use of ID bond financing	23	11	³ 2
Restricted type of project that could be financed with ID bonds	0	9	3
Caused ID bonds to be used as only a partial source of financing the total cost of project	0	⁴ 9	⁴ 1

¹The Revenue Act of 1978 raised the \$5-million-or-less limitation to \$10 million for ID bonds issued on or after January 1, 1979.

²See footnotes 1, 2, and 3, table 1.

³Limitations on size of issue did not apply to the acquisition in one case, and construction in the other, of port facilities (public grain elevators) by two interregionals with issues amounting to \$26 million and \$17.2 million respectively.

⁴Some respondents checked both the second and third items.

made in 1977 and the other in 1978—were not affected by limitations on size of issue because they did not have to qualify under the small-issue exemption to be issued as exempt ID bonds. Their use qualified as one of the exempt activities listed in Section 103(b) of the Internal Revenue Code and could be of any size.

Each of the other three interregional users, classified as farm supply cooperatives, indicated that limitations on size of issue had restricted the type of project they could finance with ID bonds. An official of one also said the size limitations had caused the co-op to use ID bonds to finance only a part of the project's total cost. Another who has used ID bonds for financing a number of projects over several years stated: "Several potential ID bond issues have not been pursued because total expenditures would exceed \$5 million at the project location over the statutory time period."

Several regional and interregional cooperative officials indicated they were stopped from using the \$5-million-or-less option because prior capital expenditures in the locality where they wanted to construct a new facility made any ID bond issue over \$1 million exceed the \$5-million limitation. When this happened, they either (1) shifted construction of the new facility to a different location where previous capital expenditures were not a constraint, (2) used the \$1-million-or-less option and financed the balance with funds from other sources, (3) went ahead with the ID bond issue bearing federally taxable interest and issued at a high rate, (4) financed the project completely from other sources, or (5) dropped the project.

Of the 150 ID bond issues that the 52 cooperatives used in financing projects, only one issue bore interest *not* exempt from Federal income taxation. This \$2.2-million non-tax-exempt issue, floated in 1977 for a regional user, could not meet the \$5-million limitation on capital expenditures for the 6-year period beginning 3 years before and 3 years after the issue. To be marketed, its interest rate had to be about 200 basis points (2 percent) higher than tax-exempt issues used by the regional cooperative; but, management still felt the financing was advantageous because of the longer repayment terms the bonds provided and the investment tax credit connected with the project.

Understanding the Restrictions

In meeting the \$1-million-or-less limitation for a specific locality, only the face amount of prior outstanding exempt small issues—used to finance facilities in the same area—has to be considered. The amount of capital expenditures has no relevance (Z, p. A-32). If prior outstanding issues plus the amount of the current issue exceed \$1 million in the jurisdiction in which the facility to be financed is located, this option becomes invalid.

Prior outstanding issues do not have to be considered if the facility to be financed is located in a different area where no outstanding exempt small issues exist. If this rule is followed, there is no limit to the number of \$1-million-or-less exempt small issues that can be made. For example, a federated regional cooperative operating in a State with 75 counties could use up to \$75 million of \$1-million exempt issues by using the proceeds to finance a \$1-million facility in each county.

Furthermore, the proceeds of a \$1-million exempt issue can be combined with any amount of funds from other sources to finance facilities costing more than \$1 million. The key point is that for a specific location, outstanding plus current issues cannot equal more than \$1 million. However, it is permissible to keep the amount outstanding at the \$1-million level. If, for example, within a period of 5 years, the cooperative had reduced the debt to \$400,000, it could have the governmental unit make another issue in its favor for \$600,000, which would bring the total dollar amount outstanding back up to the \$1-million ceiling (Z, p. A-33).

When the aggregated amount of the current plus the prior issue(s) goes beyond \$1 million, the \$5-million-or-less exemption (\$10 million or less for issues issued after January 1, 1979) comes into play. If the over \$1-million amount plus capital expenditures in the area for 3 years prior to the current issue (assumed to be issued in 1978) exceeds \$5 million, the two options have been exhausted and tax-exempt ID bond financing is out of the question.

On the other hand, if the total amount of the current issue (issued in 1978) is greater than \$1 million but not more than \$5 million when prior issues and capital expenditures are con-

sidered, it qualifies for the \$5-million-or-less exemption. Assume, for the specific locality being considered, this aggregated sum equals \$4 million, consisting of the face amount of prior exempt issues outstanding (\$1 million), capital expenditures (\$1 million), and face amount of current issue (\$2 million). To maintain the exempt status of the \$2-million current issue, capital expenditures made on the specific project being financed—or on any other facilities in the city or county where it is to be located—cannot exceed \$1 million for 3 years after its date of issue. In other words, the aggregated sum of \$4 million at the time the \$2-million current issue is made cannot exceed \$5 million for a 6-year period,

beginning 3 years before and ending 3 years after the date of the current issue.

Breaching the capital expenditures limitation and losing the exempt status of an outstanding issue of ID bonds could be costly to the user. Official statements of several of the 52 cooperative users of ID bonds indicate that if this event should happen the bonds become taxable. This means interest on the bonds must then be included in the gross income of holders for Federal income tax purposes. If this condition occurs, the bonds usually must be redeemed immediately by the cooperative and at amounts ranging from 105 percent to 108 percent of face value plus accrued interest.

PROJECTS FINANCED WITH ID BONDS

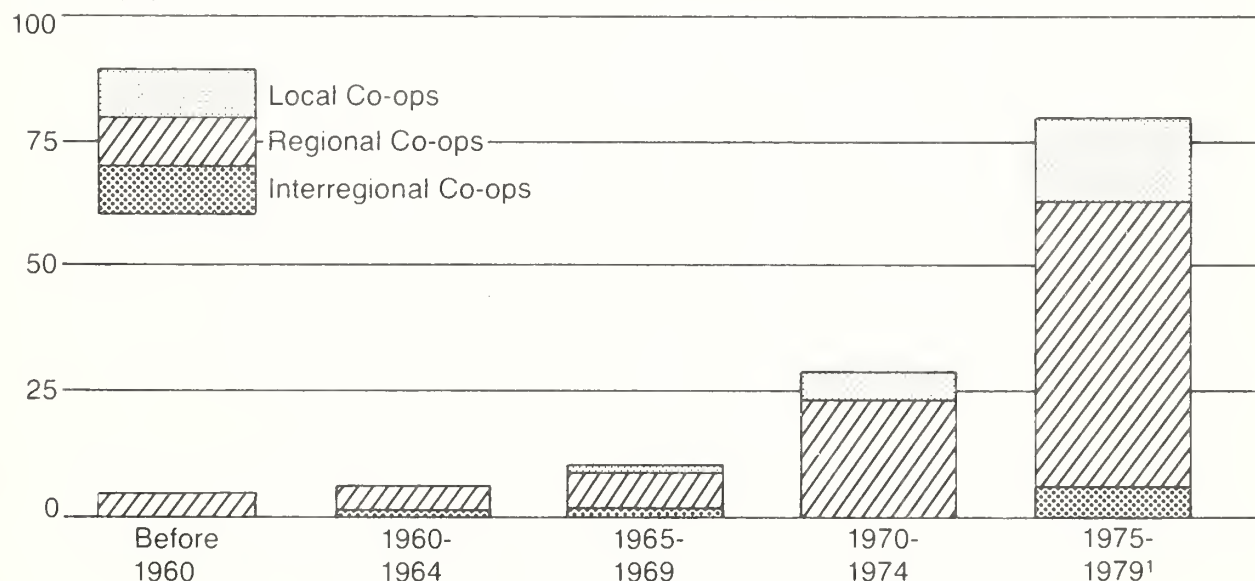
Although Congress in 1968 put restrictions on the size of ID bonds that could qualify as tax-exempt issues, the biggest growth in cooperative use of this type of financing has occurred since that time. Of the 130 projects the 52 cooperative

users have financed with ID bonds, 21 projects (16 percent of the total) took place before 1970 (fig. 1). It was during the seventies that most of the projects were funded partially or wholly with proceeds from ID bond issues.

Figure 1

Cooperatives Discovered ID Bonds in the '70s

Number of projects



¹Data for 1979 do not extend beyond June of that year.

Mississippi and Minnesota Lead

The first cooperative project financed with ID bonds was in Mississippi in 1949. But, of the 129 projects financed since then, 80 (62 percent) have originated since 1975. Mississippi is still the leader in both number of cooperative projects financed with ID bonds and total dollar amount of such funding (table 6). Two Mississippi-based regional cooperatives were responsible for initiating 24 of the 25 projects situated in that State, with the other one being started by a regional association located in an adjoining State.

Minnesota ranks next in both number of projects and amount of ID bond proceeds used to finance them. However, Minnesota, with 13 cooperatives leasing or owning 22 ID bond-financed projects located in its boundaries, leads all other States in number of associations with such projects. Six of the 13 cooperatives were regionals; six were locals and one was an inter-

regional enterprise. All were Minnesota-based cooperatives excepting the interregional which had its headquarters in Illinois.

Other key differences between the two leading States are (1) dates when projects were started and (2) average amount of bond proceeds used in financing a project. Half of Mississippi's 25 projects were started prior to 1970; all of Minnesota's 22 projects were initiated since 1973. Amount of bond proceeds used in financing Mississippi projects averaged \$2 million compared to \$1.3 million for Minnesota projects.

Only Mississippi, Alabama, and Nebraska had cooperative projects financed with ID bonds prior to 1965, and 8 of the 10 projects were located in Mississippi (table 4). Projects with such financing had spread to Kansas, Missouri, Iowa, Illinois, and Georgia by 1970, but not in any large numbers. Five of the 11 projects initiated during 1965-69 were located in Mississippi, one in Nebraska, and one each in five other States.

Table 6—Number of cooperatives with projects financed entirely or partially with ID bonds, number of projects, and amount of such financing, June 1979

State	Cooperatives	Projects	ID bond financing
		Number	1,000 dollars
Mississippi	3	25	50,970
Minnesota	13	22	28,075
Texas	1	1	26,000
Ohio	2	2	21,250
Iowa	10	13	19,045
Georgia	1	2	16,510
Wisconsin	10	15	13,480
Kentucky	2	3	12,075
Nebraska	3	4	9,900
New York	1	7	9,750
Florida	2	2	9,000
Virginia	2	2	7,500
North Dakota	6	8	6,000
California	1	1	5,615
South Dakota	4	5	5,475
Colorado	3	3	5,420
Missouri	2	2	5,300
Pennsylvania	1	3	4,365
Kansas	3	4	4,245
Alabama	2	2	2,025
West Virginia	1	1	1,500
Illinois	1	1	1,050
Oklahoma	1	1	340
Indiana	1	1	190
Total	176	130	265,080

¹Cooperatives equal more than 52, the number reporting ID bond financed projects, because several cooperatives had projects located in more than one State.

Other States surpassed Mississippi for the first time in the seventies in the number of new cooperative projects financed with ID bonds. During 1970-74, 29 new projects were initiated and 23 of them were located in States other than Mississippi (table 4). In this period, six more States were added to the roster—Minnesota, Wisconsin, New York, South Dakota, North Dakota, and Indiana—and Minnesota started 10 new projects compared to Mississippi's six. Wisconsin accounted for 4 of the other 13 projects; New York, 3; South Dakota, 2; and North Dakota, Iowa, Kansas, and Indiana, 1 each.

Largest Expansion, 1975-79

The largest expansion in cooperative projects financed with ID bonds took place from 1975 to June 1979, the cutoff date for the survey. Eighty new projects were financed during this period in 22 States (fig. 1).

Nineteen of these new projects occurred in 10 States which had their first experience with the funding of cooperative projects with ID bonds issued by a political subdivision within their own borders. These were Kentucky, Colorado, and Pennsylvania with three projects each; Ohio, Florida, and Virginia with two projects each; and West Virginia, Oklahoma, Texas, and California with one each. The majority of the other 61 projects were located in States which first began this type of financing in the 1970-74 period. These were Minnesota with 12 new projects; Wisconsin, 11; Iowa, 11; North Dakota, 7; and New York, 4. Mississippi had six new projects during this period.

Altogether, 24 States had 130 cooperative projects by June 1979 financed with proceeds from ID bond issues totaling \$265.1 million. This was an average of a little over \$2 million per association. Figure 2 shows the location of the 130 cooperative projects, classified by type, in the United States.

Figure 2

Where ID Bond Projects are Located (1979)



- Grain elevator (location of 16 projects)
- ⊙ Pollution control (location of 17 projects)
- Feed mill (location of 24 projects)
- ★ Fertilizer facility (location of 24 projects)
- Fluid milk and/or mfg. facility (location of 15 projects)
- ♦ Storage or warehouse facility (location of 12 projects)

- ✱ Soybean or seed corn processing plant (location of 5 projects)
- Poultry and/or egg facility (location of 6 projects)
- ▲ Nut shelling and vegetable processing plant (location of 3 projects)
- ◆ Land and office buildings (location of 3 projects)
- △ Other (location of 5 projects)

Table 7 relates the 130 projects to the different types of cooperatives among the 52 associations using ID bond financing. These projects, averaging 2.5 per cooperative, had \$265.1 million of ID bond capital invested in them. The median amount of such financing per project equaled \$1 million. There were 150 ID bond issues involved in funding the 130 projects (table 4). This happened because additional issues were made to finance expansions and improvements to the original project in some cases.

There were about as many local as regional cooperatives using ID bonds as of June 1979. But, the 24 regionals accounted for 96 (74 percent) of the 130 projects. The 24 regionals averaged four projects per cooperative and the 5 interregionals averaged two projects each.

Local Cooperative Projects

Except for one project begun in Kansas in 1966, the other 23 local cooperative ID bond financed projects were started between 1974 and 1978. Half of the local cooperatives' 24 projects were located in Minnesota and Wisconsin with

six projects each (table 7). The other 12 local projects were situated in seven States with 3 in Iowa; 2 each in South Dakota, Colorado, and North Dakota; and 1 each in Kansas, Nebraska, and Oklahoma.

Projects Leased or Owned.—ID bonds issued by local government units to finance the 24 projects leased or owned by 23 local cooperatives ranged from \$130,000 to \$1.5 million, with a median of \$673,000 (table 7). The municipal issuer acted as lessor in most cases and leased the project to the local cooperative lessee, with the lease agreement extending over a time period equal to the term of the bonds used to finance the project. The municipal issuer loaned the ID bond proceeds to the local cooperative to fund the project in a few instances. In this kind of an arrangement, the title of the project stayed with the local cooperative and no long-term leasing agreement was involved.

Revenue-type Bonds Used.—All of the issues used to fund the 24 local projects were revenue bonds in which the municipal issuer was under no obligation to assume principal and interest payments if the local cooperative

Table 7—Number of projects wholly or partially financed with ID bonds, classified by type of cooperative and total and median amount of such financing, June 1979

Type of cooperative	Cooperatives	Projects	ID bond financing	
			Total	Median
	Number		1,000 dollars	
Local: ¹				
Grain	12	12	8,345	650
Dairy	6	7	6,470	975
Farm supply	5	5	2,775	225
Subtotal	23	24	17,590	(avg.) 673
Regional: ¹				
Diversified	7	48	96,801	1,700
Dairy	6	8	11,900	1,000
Farm supply	5	32	55,734	1,000
Grain	2	4	6,780	1,750
Sugar	2	2	1,800	900
Fruit and vegetable	1	1	5,615	5,615
Poultry	1	1	1,500	1,500
Subtotal	24	96	180,130	(avg.) 1,300
Interregional: ¹				
Farm supply	3	8	24,110	1,780
Grain	2	2	43,250	21,625
Subtotal	5	10	67,360	2,250
Total	52	130	265,080	(avg.) 1,000

¹See footnotes 1, 2, and 3, table 1.

defaulted. None of the 23 local cooperatives had indicated any problems in meeting their obligations connected with ID bonds as of June 1979.

Twenty-one of the 24 issues were made by a city or town, with the other three issued by a county. Population of the city and town issuers ranged from 47,300 to 185 people, with a median of 2,200. Terms of the 24 issues ranged from 6 to 20 years, with a median of 13 years.

Most of the 24 issues were serial in nature, in that portions of the principal or face amount of the bonds matured periodically over the life of the issue. A few issues were term in that the principal matured all at one time. The rate of interest on the 24 ID bond issues varied from 8.5 percent to 5.5 percent, with a median of 7 percent.

The 12 grain locals used the greater share of the \$17.6 million of ID bond funds spent on projects of local cooperatives (table 7).

Regional Cooperative Projects

The 24 regionals have used ID bonds as a source of funds more extensively over a longer period of time than the locals. Their use extends from 1949 up to June 1979, the cutoff date of the survey. The 96 projects they financed with proceeds from ID bond issues amount to \$180.1 million, more than 10 times that of the 23 locals and three times that of the 5 interregionals. Of the \$265.1 million of total ID bond capital the 52 cooperatives used to finance 130 projects, two-thirds was vested in the 96 projects of the 24 regionals.

Size of Project. — The 96 projects of the 24 regionals averaged \$1.3 million (table 7). In some cases, they used more than one issue of ID bonds on the same project to fund additions to facilities. The municipal issuer usually acted as the lessor in connection with ID bond issues and leased the project to the cooperative lessee for the time required to pay back the principal on the bonds.

Net Leases. — The leases connected with ID bond-financed projects were usually net leases and not true leases as described in the Internal Revenue Code. The cooperative lessee usually treated the net leases as capitalized lease obligations and included them in both the asset and liability sections of the balance sheet.

This kind of treatment allowed the lessee to claim the benefits of owning the project, such as use of depreciation and investment tax credits. The cooperative handles the lease as if it were a long-term installment purchase of the project. The lease payments it makes *exclude* costs of operation and ownership of the project and *include* only payments for principal and interest on the ID bonds.

General Obligation ID Bonds. — Of the 113 issues floated to finance the 96 projects of the 24 regionals, only 12 were general obligation ID bonds and 101 were of the revenue type. None of the local or interregional cooperatives used general obligation ID bonds to finance any projects. All of the 12 general obligation issues were used by two regionals in Mississippi.

All but three of the issues were made prior to the seventies and usually were small, ranging from \$125,000 to \$800,000, with a median of \$300,000. The first ID bond issue made in 1949 in Mississippi to finance a cooperative project was a \$750,000 general obligation issue.

Type of Issuer. — Municipal issuers of ID bonds used to finance 96 regional cooperative projects consisted of 55 cities and towns, 40 counties, and one State pollution control financing authority. The “port authority” of a city was listed as the issuer of the bonds in one of these projects. And, among the county issuers, one had set up what it called an “industrial development agency,” another an “economic development authority,” and another a “payroll development authority” to issue the ID bonds. Population of the 55 city and town issuers ranged from 434,400 to 210, with a median of 5,300 people.

Terms of Issues. — Length of maturity of the 113 issues ranged from 7 to 30 years, with a median of 15 years. The rate of interest varied from 8.4 percent to 1.8 percent, with a median rate of 6.2 percent.

Most of the 113 issues were set up on a serial basis with repayment of principal allocated over the total time the bonds were outstanding. This type of arrangement makes it easier for cooperatives to schedule debt service payments on the bonds. Spreading principal payments over a number of years to coincide with revenues on the project(s) financed helps the cooperative maintain an adequate level of working capital and

avoids a heavy drain on cash flow in any one year.

Regionals With Most Projects. — Diversified and farm supply regionals, accounting for half the regionals, had 83 percent of the regional projects (table 7). Projects of these 12 regionals also made up 62 percent of the 130 ID bond financed projects of the 52 cooperatives using this source of funds. They also accounted for about 58 percent of the \$265.1 million of ID bond money invested in the 130 projects.

The seven diversified regionals, with median sales of \$1.3 billion, were the largest cooperatives among the 52 associations using ID bonds. They were also the most experienced users of ID bond financing, averaging 6.9 projects each. Five farm supply regionals averaged 6.4 projects. However, the median amount of ID bond money used in the diversifieds' 48 projects (\$1.7 million) and the farm supply co-ops' 32 projects (\$1 million) was not as high as that of some other regionals.

The \$5.6-million project of the fruit and vegetable regional was for water pollution control facilities. ID bonds used to finance this type of activity can be any size and do not have to qualify under the small-issue exemption which, prior to January 1, 1979, limited size of issue to \$5 million or less. The four projects of the two grain regionals also averaged slightly more than the 48 projects of the diversifieds but were typical of the size of projects used by many regionals and interregionals (table 7).

Interregional Cooperative Projects

Seven of the 10 projects the five interregionals financed with proceeds from ID bond issues were started between 1976 and 1979. The other three were initiated in the sixties. The interregional projects had the largest median amount of ID bond capital invested in them, compared to regionals and locals.

Most unusual is the two grain interregional's projects with a median of \$21.6 million. As with the pollution control project, bond issues financing the purchase and construction of grain elevator port facilities can be any size when the proceeds are used for this kind of activity. ID bonds issued to finance such an exempt activity—as described in Section 103(b) of the code—do not

have to qualify as an exempt small issue to bear interest exempt from Federal income taxation.

All 13 issues made to finance the five interregionals' 10 projects were revenue ID bonds. The official statement describing one of the issues indicated: "The bonds are special obligations of the city, payable solely from and secured by a pledge of certain revenues from the project. The bonds do not constitute a general obligation of the city or a charge against the general credit or taxing power of the city. No bondholder shall have the right to demand payment of principal, premium, if any, and interest on the bonds out of any funds raised by taxation."

The government units issuing the ID bonds used by the interregionals consisted of nine cities and four counties. One county had formed an "industrial development authority" to issue the bonds. In another, a county-and-city-controlled "port authority" was the issuer. Population associated with the nine city issuers ranged from 60,500 to 1,780, with a median number of 23,900 people.

Maturities of the interregional issues varied from 10 to 30 years, with a median term of 15 years. Interest rates varied from 4.5 to 8.25 percent, with a median of 6 percent. Maturity of principal of the 13 issues was about evenly divided between term and serial types.

Types of Projects

Table 8 describes the type of projects cooperatives have funded with proceeds from ID bond issues.

Grain Elevator Projects. — Grain elevator construction or expansion was the leading type of project from the standpoint of number of cooperatives with such projects and total amount of ID bond capital used in financing them (table 8). However, the most numerous types of projects were feed mills and fertilizer plants.

Of the 16 enterprises reporting grain elevator projects, 11 were local cooperatives, 3 were regionals, and 2 were interregionals. One large project involving the acquisition and another the construction of public grain elevators by two interregionals accounted for 72 percent of the \$61 million of ID bond capital spent on these 16 projects. Five ID bond issues were used to fund the two projects. Maturities of the two

serial and three term issues ranged from 10 to 30 years, with an average life of 18 years.

The other 14 projects were considerably smaller, ranging from a \$175,000 ID bond issue used by a local grain cooperative to partially finance the construction of a country grain elevator (costing \$360,000) to a \$4-million issue used by a diversified regional to build a grain terminal elevator. Median size of the issues floated to finance the 14 projects was \$1 million. Terms of the issues ranged from 9 to 20 years, with an average life of 14 years. All 16 grain elevator projects were initiated since 1974, with most of them started during the 1976 to June 1979 period.

Pollution Control Projects.—Next in importance to grain elevator projects was projects for pollution control (or abatement) facilities. Over \$51 million of ID bond proceeds were used by seven cooperatives to finance 17 projects in this category (table 8). ID bond issues for air and water pollution control facilities as well as public grain elevator storage facilities can generally be of any size, and the interest they produce may still be exempt from Federal income taxes.

Associations reporting this type of project consisted of six regionals and one interregional

concern. The projects were initiated between 1973 and 1978. Three of the 17 projects varied from \$8 million, to \$12.7 million; the other 14 ranged from \$315,000 to \$5.6 million. The median size of these ID bond issues was \$1.2 million. Maturities of the 19 issues involved ranged from 7 to 25 years, averaging 15 years.

Feed Mill Projects.—Eight regionals and two locals accounted for the feed mill projects (table 8). Five diversified regionals among the eight accounted for 18 of the 24 projects, with four of the five each having four feed mills financed by ID bonds.

Fifteen of the 24 feed mills were built between 1975 and 1977, with five of the other nine from 1970-73. Only four were built during the sixties. ID bond issues used to finance the 24 projects ranged from \$175,000 to \$4.5 million, with a median of \$1.6 million. Maturities of the 24 issues ranged from 10 to 25 years, averaging 17.6 years.

Fertilizer Projects.—Three farm supply regionals and one farm supply interregional cooperative accounted for 19 of the 24 fertilizer plant and facility projects (table 8). A diversified regional and three local farm supply associations had the other five projects. Twenty-seven issues

Table 8—Number of farmer cooperative projects financed with ID bonds from 1949 to 1979, classified by type of project, number of cooperatives reporting each kind, and amount of such financing¹

Description of project	Cooperatives ²	Projects	ID bond financing
	Number		1,000 dollars
Grain elevator construction or expansion	16	16	60,955
Pollution control (or abatement) facilities ³	7	17	51,695
Feed mills or plants	10	24	41,090
Fertilizer plant and facilities	8	24	26,234
Fluid milk and manufacturing facilities	11	15	21,635
Storage or warehouse facilities ⁴	8	12	20,335
Soybean or seed corn processing plants	5	5	16,975
Poultry and or egg facilities ⁵	3	6	11,921
Peanut and pecan shelling and vegetable processing plants	3	3	5,450
Land and office buildings	3	3	1,790
Other ⁶	4	5	7,000
Total		130	265,080

¹Data for 1979 do not extend beyond June of that year.
²Cooperatives equal more than 52, the number reporting ID bond financed projects, because several cooperatives had more than one project financed this way.
³Includes sewage or solid waste disposal facilities.
⁴Such projects for fertilizer are included under the fertilizer plant and facilities classification.
⁵Includes a broiler and a turkey hatchery project.
⁶These projects and amount of ID bond issues used to finance them were: margarine plant, \$2.2 million; six retail stores, \$2 million; computer, \$1 million; automotive service center, \$1 million; and honey processing plant, \$800,000.

were involved which ranged from \$74,000 to \$7 million, with a median of \$750,000. Terms varied from 10 to 25 years, averaging 16.2 years.

The first cooperative project financed with ID bonds was a fertilizer facility in 1949. This project, plus five others for the same farm supply regional, and three for a farm supply inter-regional were the only ones constructed prior to the seventies. The other 15 fertilizer projects, except one built in 1974, were started by seven cooperatives during the 1976-78 period.

Three farm supply locals and one regional farm supply federation constructed six fertilizer blending plants in 1978. This type of facility is one that both local and regional farm supply cooperatives were successful in financing with relatively small issues of ID bonds. The six issues involved ranged from \$130,000 to \$350,000, with a median of \$238,000. This is considerably smaller than the \$673,000 median of the 24 issues used to finance the 24 projects of local cooperatives.

Fluid Milk Projects. — Fluid milk and manufacturing facilities were popular projects in which more local cooperatives than regionals or interregionals were involved (table 8). Six locals and five regionals were involved. ID bond issues used to finance these projects varied from a \$250,000 issue sold in 1978 to build a bulk milk receiving station to \$4.2 million for the construction of a cheese manufacturing facility in 1973. Median size of the 15 issues was \$1 million. Their terms ranged from 5 to 20 years, averaging 11.3 years. Except for one project started in 1966, the other 14 were begun during the 6-year period 1973-78.

Storage or Warehouse Projects. — Six regional cooperatives started storage or warehouse facility projects while two interregionals started such projects between 1975 and 1978 (table 8). The 14 ID bond issues associated with the projects ranged from a \$225,000 issue marketed in 1978 to finance a warehouse to a \$3-million issue placed the same year to construct a milk storage facility. The median issue amounted to \$1.3 million. Their terms varied from 10 to 25 years, averaging 15.7 years.

Soybean or Seed Corn Projects. — Five such projects were constructed by five regionals: three diversified and two farm supply cooperatives (table 8). Except for one plant built in 1967, the

other four came on stream during 1974-78. The six issues associated with these projects ranged from a \$900,000 issue to finance a hybrid seed corn plant in 1975 to a \$6-million issue for funding a soybean processing plant completed in 1968. Median size of the issues was \$2.4 million. Their terms ranged from 10 to 30 years, with a 17-year average life.

Poultry or Egg Projects. — Six poultry or egg facility projects were reported by three regional diversified cooperatives (table 8). Two located in Mississippi and Georgia were responsible for five of the six projects. The other project, a turkey hatchery, began in Minnesota in 1978.

Three of the five southern projects were started in the late fifties and early sixties and two of these — an egg facility and a broiler processing facility — got their initial financing from general obligation ID bond issues. The other two southern projects, a poultry and an egg facility, began operations in the early and midseventies and one of these also used general obligation ID bond capital for initial financing.

Eleven ID bond issues (six general obligation and five revenue) were associated with the six poultry or egg facility projects because additional issues were made in connection with three of the projects to cover additions and improvements (in one instance, the refunding of an earlier issue). The 11 issues ranged from \$125,000 to \$3.1 million, with a median of \$354,000. Their maturities ranged from 10 to 20 years, with an average term of 16.8 years.

Peanut, Pecan, and Vegetable Projects. — The peanut, pecan shelling, and vegetable processing plants were projects begun by regional cooperatives (two diversified and one farm supply) located in the South (table 8). Two of these projects started in the midsixties and one in 1977 had \$5.4 million of ID bond capital invested in them.

Five issues were connected with the financing of the three projects because the vegetable processing project had three separate issues made over a number of years to cover plant expansions. The initial issue was a general obligation ID bond and the latter two were ID revenue bonds. Size of the five issues varied from \$350,000 for financing a pecan shelling plant to \$1.7 million for constructing a peanut shelling plant. The median equaled \$1 million. Four of

the five issues each had a 20-year life. This information was not reported for the other issue.

Office Building Projects.—The three issues made in 1973 and 1974 to finance land and office buildings varied from \$190,000 to \$1 million and averaged \$597,000 (table 8). Two of the issues had 10-year lives and the largest one, 20 years.

Other Projects.—Five projects put in the other classification involved six issues, with two floated in 1968 and the other four during 1974 to 1976 (table 8). Three regionals and one local cooperative accounted for the five projects. The local supply cooperative used a \$1-million issue

to pay construction costs of a new automotive service center. One diversified regional used a \$2-million issue to finance the building of six retail stores and another used a \$1-million issue to obtain a computer.

Issues sold to finance the other category projects ranged from a \$2.2-million one made in 1975 to cover acquisition costs of a margarine manufacturing plant to an \$800,000 issue to finance construction costs of a honey processing plant. The median was \$1 million. Terms of the issues varied from 10 to 20 years, with an average life of 14.3 years.

REASONS FOR SELECTING ID BONDS

Cooperatives obtain long-term debt financing from many sources. Banks for Cooperatives have been the primary supplier of borrowed funds, furnishing over 60 percent of cooperatives' total borrowings. Other sources include commercial banks, insurance companies, other cooperatives, long-term capitalized leases, debenture bonds, and ID bonds.

To obtain a quantitative reading of the reasons why the 52 cooperatives went the ID bond route instead of using some other means to finance the 130 projects, we asked them to consider a list of advantages, and rank them in order of importance from one to eight with one being the most important. Table 9 shows how the cooperatives ranked the advantages and gives the mean score and standard deviation of each one considered.

The standard deviation (SD) is a widely used means of measuring dispersion and is based on deviations from the mean. It indicates the degree of agreement among the cooperatives in scoring each of the listed advantages. The larger the SD value the more widely varied was the cooperative scoring of a specific item. A smaller SD value, however, indicates closer agreement in ranking an advantage.

Lower Interest Cost

Lower interest cost relative to other sources of long-term borrowed funds ranked as the most important advantage of ID bond financing. On-

Table 9—Advantages of ID bond financing ranked in order of importance by farmer cooperatives using this method of funding, June 1979

Advantage and rank ¹	Mean score ²	Standard deviation ³
	Value	
1. Lower interest cost	1.3	1.01
2. Longer repayment terms	3.2	1.94
3. 100 percent financing	3.8	1.79
4. Improves cash flow and liquidity	3.8	1.35
5. Preserves working capital	4.2	1.20
6. Creates community understanding and support for the cooperative	5.1	2.14
7. Exemption from local property taxes	5.8	2.26
8. Insures that property is available for the project	6.7	0.91

¹Ranked in order of importance from 1 to 8 with 1 being the most important score.

²Sum of scores given to each listed advantage divided by number of cooperatives doing the ranking.

³The smaller the value the more closely alike were the scores each cooperative gave to a specified advantage in ranking it.

ly nine cooperatives ranked this advantage other than first, with five giving it a second rating and four placing it third. The small 1.01 standard deviation indicates the close grouping of the scores given to this advantage.

One diversified regional with four feed mills built with ID bond issues estimated it had saved an average of 200 basis points (2 percent) in interest costs by using this method of financing. An official of a farm supply regional cooperative, with 10 projects acquired or constructed with ID bond proceeds, was enthusiastic about this source of long-term debt capital. Without

considering front-end expenses (that is, fees paid to underwriters, bond counsel, etc.), the official figured that by using ID bonds annual savings in interest cost equaled \$132,000 and thus exceeded \$2 million over the 15.2-year average term of the bonds.

Longer Repayment Terms

The second ranked advantage of ID bond financing was longer repayment terms than available from other sources for long-term debt. Five cooperatives ranked this item first. Several, however, rated it third or lower. Its larger standard deviation than the top-ranked advantage shows the cooperatives were not in as close agreement in rating this factor as they were in picking the first ranked advantage.

Several cooperatives reported a major reason for using ID bonds was because Banks for Cooperatives would not go beyond 6 to 10 years on term loans. One regional's financial services manager emphasized that he liked ID bonds because in all of its ID bond-financed projects the cooperative had been able to match the useful life of the project—which may run from 15 to 20 years—with the term of the bonds.

Other Reasons

"100 percent financing" and "improves cash flow and liquidity" tied for third place. One diversified regional official rating "100 percent financing" as his top choice had used 16 ID bond issues in building and making additions to nine projects.

"Preserves working capital," which is related to improving cash flow and liquidity, was ranked fourth.

Although "creates community understanding and support for the cooperative" ranked fifth in importance, four locals rated this as the top-ranked advantage of ID bonds. Two locals and one regional cooperative also placed it second, and several associations rated it sixth, seventh, or last. The comparatively high standard deviation of this advantage (only "exemption from local property taxes" had a larger one) attests to the wide range of ratings it received.

Ratings also ranged from one to eight for "exemption from local property taxes." Five cooperatives, however, considered this a major ad-

vantage of ID bond financing, ranking it first, second, or third in order of importance. The eighth-ranked factor was "insures that property is available for the project." Its main distinction was that it possessed the smallest standard deviation of all the advantages rated, indicating the close agreement among the cooperatives in ranking this factor last.

An additional advantage of ID bond financing one regional official cited was "exposure to financial community." Another plus for this type of financing is that ID bond issues, whether sold publicly or privately, do not have to be registered with the Securities and Exchange Commission (SEC). None of the 150 issues used by the 52 cooperatives to finance projects had to have SEC registration. Several cooperatives predicted the appeal of ID bonds would decline substantially if such registration should become mandatory, because of the extra cost and time involved in meeting such requirements.

Viewpoints of Local Cooperatives

Sixteen of the 23 locals indicated they went the ID bond route because this was the cheapest means of financing their projects. Only two locals indicated they used ID bonds because other sources of long-term financing were unavailable. One local cooperative assumed an ID bond obligation when it purchased a facility financed with ID bonds still outstanding. The other four stated they chose ID bonds mainly because they wanted (1) their stockholders and local people to get involved in financing a cooperative project, (2) to make available to local people the advantages of ID bond interest, and (3) to keep interest money in the local community. One of the four also indicated it obtained an \$850,000 Bank for Cooperatives loan in conjunction with a \$700,000 ID bond issue to cover the cost of constructing a \$1.6-million grain elevator. The loan is secured by a first mortgage on all property of the local, including the project, and the bondholders hold a second mortgage subordinate to the rights of the bank.

Only three co-ops indicated that the municipality³ offered the co-op inducements or incentives in connection with projects in addition to ID bond financing. Twenty indicated a nega-

³The term municipality herein refers to the State or local government unit or body issuing ID bonds, such as city, town, county, industrial development authority, corporation board, etc.

tive response. Of the three locals responding affirmatively, the inducements referred to concerned *ad valorem* or local property taxes.

One local that financed a \$1-million grain elevator in South Dakota with ID bonds indicated the city gave it a 5-year tax buildup period before having to pay all of the property tax due each year on the project. During the first and second years the project was in operation, the cooperative paid only 25 percent of the yearly property tax assessed on it, 50 percent the third and fourth years, 75 percent the fifth, and 100 percent from then on.

The other two locals, one in Kansas and the other in North Dakota, indicated the cities issuing the ID bonds to finance their projects also exempted the projects from local property taxes. However, in both cases, the cooperatives specified making payments in lieu of property taxes. One local paid a “flat rate of \$4,000 per year to cover all city costs,” and the other made a “gift to the city government to help defray expenses.”

Other comments from local cooperative users of ID bond financing included these:

—“By using ID bonds we got financing at a lower rate and our cash flow has been improved by going this route.”

—“ID bonds offered us long-term interest savings and a repayment program more suited to the potential pay-back period of the project. It’s been a good community and local bank interest project.”

—“At this time we are pleased with our venture in this financing field. We had no difficulty selling the bonds.”

—“If it hadn’t been for ID bond financing, we would have been unable to put up the size facility necessary to meet our demands.”

—“Because of rising costs and inflation, the cooperative should have used a \$1-1/2 million instead of a \$1 million issue and set the term for 15 or 20 years instead of 10.”

Viewpoints of Regional and Interregional Cooperatives

All 24 regionals indicated a preference for ID bonds because such bonds represented the least cost means for getting the job done. None indicated they chose this method of financing

because other sources of long-term funds were unavailable, although one regional official did specify: “Only partial financing on a long-term basis was available from other sources.”

Six of the eight regionals listing other major factors specified “longer maturity or repayment period” as an important reason. As one co-op official put it: “Term loans from Banks for Co-ops were limited to 6 years—we needed 20.” Another regional official said, “A combination of higher interest rates from private sources and shorter term of loan caused us to use ID bonds.” Two of the eight also listed the long-term fixed or locked-in interest rate that ID bonds provided as a significant factor in persuading them to choose this means of financing. And one regional official noted that the “100 percent financing” the bonds provided and “not having to tie-up operating capital” were key elements in selling it on this type of funding.

Did the municipality offer any incentives in addition to ID bond financing of projects? Nine regionals answered yes. Fifteen said no. Of the nine responding affirmatively, each mentioned taxes, and, in addition, one regional indicated “free site preparation” for its projects.

Eight of the nine regionals’ tax incentives had to do with local property taxes. The other regional indicated that two of its projects were exempted from State income taxes. Four of the eight regionals—located in Mississippi, Georgia, Alabama, and Kentucky—reported that their ID bond financed projects received exemption from local property taxes. Neither were the four cooperatives required to make any payments to the municipality in lieu of the exempted property taxes granted to the projects. Nor did the other cooperative not paying State income tax on two of its projects have to make any such payments.

However, four regionals checking “exemption from local property taxes” reported they did make in-lieu payments. One cooperative said it paid a service fee; another, “A payment in lieu of taxes was negotiated in all cases;” a third, “After renter has paid principal and interest on bonds, rental is reduced to an amount which would be due as *ad valorem* taxes if the facility were owned by the cooperative.” The fourth regional stated: “We made full payment—the lower interest rate was our main objective as well as the longer length of repayment.”

Eleven of the 24 regionals made additional comments about their experience with ID bonds. They included:

– “We believe ID bonds are an excellent source of comparatively low-cost funds. When bonds are paid, project becomes wholly-owned by cooperative.”

– “ID bond financing ties local community closer to the cooperative.”

– “Have found ID bonds a beneficial means of acquiring needed facilities for the benefit of the membership.”

– “ID bond financing is good because of the lower interest rates.”

– “Practical for financing projects totaling \$300,000 and up. Need to prepare a schedule of events to get project completed. Requires a coordinator to follow up details.”

“Very pleased with the opportunities and savings available.”

“We have financed only one project with ID bonds. Would consider this method again only if it appears to provide us with an advantageous alternative source of long-term financing.”

“Be certain to understand requirements

of trustee bank. Colorado does not seem to want to encourage business. Our issue in Kansas was easy and simple.”

All five interregionals preferred ID bonds because such bonds provided the necessary funds at the lowest cost. For example, one co-op official estimated that by using ID bonds to finance a grain elevator, the co-op will save millions of dollars in interest costs over the 20-year period set to repay the debt. As the interregional manager stated: “ID bonds enabled us to lock-in a very attractive interest rate for a 20-year term.”

One interregional official listed “longer period available for repayment” and another “property tax relief” as important considerations in persuading them to select ID bonds. Officials of two cooperatives checked “exemption from local property taxes” but as one explained: “The cooperative receives an annual invoice from the city in lieu of property taxes. The invoice represents the co-op’s share of the local school tax assessment.” The other made no in lieu payments. Therefore, only one of the five interregionals obtained any inducements from the municipality in addition to ID bond financing of the project.

DISADVANTAGES OF ID BONDS

When the respondents were asked to rank, in order of importance, a list of disadvantages from one to five, 46 of the 52 associations surveyed ranked one or more of the items given (table 10). No single item was ranked by all 46 enterprises because in some instances a cooperative rated only two or three of the listed items without scoring the others. The item receiving the lowest score in table 10 is perceived as being the biggest disadvantage.

Time and Red Tape for Approval

Eighty-two percent of the 45 cooperatives scoring the top-ranked disadvantage (see table 10) either ranked it first or second in importance. One local manager commented that: “The red tape connected with ID bonds required a lot of additional study time on my part to understand the procedures involved in obtaining

this type of financing.” And, the treasurer of a regional said: “One reason we would not use this type of financing in the future is the impossibili-

Table 10—Disadvantages of ID bond financing ranked in order of importance by farmer cooperatives using this method of funding, June 1979

Disadvantage and rank ¹	Mean score ²
	Value
1. Amount of time and red tape required to get an issue approved	1.9
2. Financing costs connected with issues	2.3
3. Restrictions on size of bond issue that can qualify as an exempt small issue	2.5
4. Substantial users restriction	3.9
5. Costs of meeting State securities law requirements for registration and reports	3.9

¹Ranked in order of importance from 1 to 5 with 1 being the biggest disadvantage.

²Sum of scores given to each listed disadvantage divided by number of cooperatives doing the ranking.

ty of making changes in any type of construction plans once the project has been approved." Another regional's financial vice president stated: "The red tape is expensive and could be improved; however, with different State laws this will be very complicated to change."

Financing Costs

Voted as the next most important disadvantage was "financing costs connected with ID bond issues." Since bond issue costs are a major factor to be considered in all types of bond financing—whether the obligations being issued are debentures, municipal bonds, or ID bonds—it is noteworthy that this item ranked second instead of first. Ten associations ranked this factor first; 16, second; and 13 cooperatives gave it a third or lower rating.

Restrictions on Size of Issue

Restrictions on the size of the bond issue that can qualify as a tax-exempt small issue ranked as the third most important disadvantage of this type of financing. Of the 35 cooperatives ranking it, 11 put it in first place; 6, second; and 18, third or lower position. How the \$1-million and \$5-million limitations (\$10 million for ID bonds issued on or after January 1, 1979) affected cooperatives was covered in detail in an earlier section of this report.

Other Factors

Tied for last place in the ranking of disadvantages was the "substantial users restriction" and "costs of meeting State securities law re-

quirements for registration and reports." Whereas constraints on the dollar amount of the bond issue affect size of the project, the "substantial users" factor relates to marketing the issue. Section 103(c) of the Internal Revenue Code explains that the interest paid on ID bonds held by a substantial user of a facility is not tax exempt.

The code says a substantial user generally is a person who regularly uses the facility for trade or business. If the facility was not specifically built, rebuilt, or purchased for the user, that person will be treated as a substantial user only if that person accounts for 5 percent or more of the gross revenue derived by all users of the project, or occupies 5 percent or more of the usable area of the facility (7, p. A-39; 13, p. 335). Other than rating this factor last, no cooperative indicated having any specific problems with it.

Six concerns did not rank any of the listed items. However, the general manager of one of the five locals in this group specified: "The major disadvantage we've experienced with ID bond financing is that the mortgage securing the bonds covers all present (and future) facilities over the 10-year life of the obligations—thus limiting financing from the bank for cooperatives and other sources during this period." Another official of one of the locals replied that it was "too early yet" to rank any of the listed items and a couple indicated none of the listed disadvantages were applicable and furthermore they "couldn't think of any."

The one interregional not ranking any of the listed items also stated: "Our experience with ID bonds so far indicates no major drawback with this type of financing."

ISSUING AND PLACING ID BONDS

ID bonds are different from debenture bonds issued by a cooperative because the issuer of ID bonds is a government agency and is not the user of the bond proceeds. The 52 co-ops were questioned on the requirements imposed on them to qualify for ID bond financing, the prerequisites of the municipality, the sources of assistance, and other items relating to the buying and selling of ID bonds.

Requirements of Cooperative

Since an association must get a municipality to issue the bonds and then decide how best to market the issue, the question was asked: "What requirements or standards did your co-op have to meet to qualify the project(s) for ID bond financing?" Only one local failed to check any of the listed items; this was because the current

manager was not with the cooperative when it initiated the ID bond financing.

Nearly 73 percent of the cooperatives responding reported that to qualify the project(s) for ID bond financing entailed the preparation of an official statement, placement memorandum, or financing circular for submitting to purchasers of the ID bonds. These documents, most commonly referred to as an "official statement," vary from 12 to over 40 pages of printed material. Their length depends largely on the amount of the financing, the size of the cooperative, and whether the bonds are to be sold to the local banker, for example, or offered to a large number of investors with little or no knowledge of the cooperative.

Such statements normally begin with a brief introduction on the purpose of the financing and then describe the authority issuing the bonds, the enabling statute(s) under which they are issued, and whether they are revenue or general obligation bonds. Next, the project and bond characteristics are explained, along with the lease or loan agreement, guaranty, indenture, and tax exemption features of the issue. Finally, information is often provided (as an appendix to the statement) about the organization and operation of the cooperative, including its most recent audit report.

About half of the cooperatives reported submitting justification statements or financial reports to the municipality as part of the procedure in getting the bonds issued. A fourth of the co-ops indicated their financial condition had to meet certain standards and balance sheet ratios. And, about 20 percent said that the municipality must be convinced that the project(s) would create a minimum number of new jobs in the community before it would agree to issue the bonds.

Other requirements and comments mentioned by about 12 percent of the cooperatives indicated (1) the project must meet a public purpose, (2) an inducement contract had to be obtained from the city council, (3) the cooperative had to demonstrate to a local bank purchasing the bonds its ability to pay off the indebtedness, (4) the cooperative cleared the project with the bank for cooperatives and got its "OK" before proceeding with ID bond financing, and (5) disclosures connected with this type of financing were comparable to those required

by the Securities Act of 1933 pertaining to registration with the SEC.

Prerequisites of Municipality

All 52 co-ops responded to the question: "What prerequisites did the municipality have to satisfy before ID bonds could be issued for the project(s)?"

About 10 percent of the cooperatives mentioned "publishing notice of offering in local paper" as a requirement the municipality had to meet prior to issuing the bonds. Nearly half the cooperatives indicated a public hearing was also necessary. Almost 31 percent said that the local government unit planning to issue the bonds had to get "approval from a State agency" before going ahead with the project.

Only four cooperatives (7.7 percent) reported that ID bond approval required an election by the voters of the local government unit proposing to issue the obligations. This is fortunate because such a referendum is time consuming; two of the cooperatives indicated this experience added 60 to 90 days in getting the issues (eight general obligation and one revenue) approved.

Two cooperatives reported validation of bonds by court decree as a prerequisite. One interregional official specified: "The county industrial development authority authorizes the financing and then the bonds are validated by a judgment of the circuit court."

Such prerequisites are in addition to approval by the city council, county board of commissioners or supervisors, or the industrial or economic development authority of the municipality, county, or other political subdivision issuing the bonds. In several cases, however, this was the only prerequisite needed to issue the bonds. One regional official stated: "Under State law you are required to publish the offering in the local newspaper. Unless there is a petition for an election, authorization by the county board of supervisors is all that is required."

Sources of Assistance

Where can a co-op go for help in obtaining ID bond financing? If it is a local member of a regional, it should check with the regional about the best way to proceed. Chances are good that

the regional has already used this source of funds and can readily assist the local on steps to take. If the county in which the cooperative is located has an economic or industrial development authority, it should be contacted for advice.

Interregional Service Corporation (ISC), a Minneapolis-based leasing company owned by a group of regional cooperatives, recently expanded its services to include helping cooperatives with this type of funding. A large farm supply regional reported using ISC in arranging ID bond financing for several projects.

Investment bankers were the most important source of assistance cooperatives used in ID bond financing with 38 (76 percent) of the 50 associations checking this source. Twenty-four of the 38 cooperatives checking "investment bankers" also indicated they used "bond counsels or advisors" as well. Altogether, 29 cooperatives (58 percent) reporting using the latter source ranked it second in importance.

The treasurer of a large diversified regional with ID bond-financed projects in excess of \$20 million advised: "Getting the right underwriter—one who has clout with the bond counsel—is the key to the whole thing. Besides being able to sell the bonds at the lowest possible interest rate, a good underwriter rides herd on the bond counsel to make sure he moves as rapidly as possible in drafting all the necessary legal documents in conformity with federal and State regulations."

Nine cooperatives (18 percent) indicated that "State and/or local development authorities" provided assistance with ID bond financing. Two locals and one regional checked this as the only help they needed; another local reported also obtaining the services of a local attorney. The other five (regionals) noted that help was received from investment bankers and bond advisors in addition to development authorities.

Commerical banks were mentioned by three locals and three regionals as playing a key role in assisting them with their ID bond financing. One local co-op official stated: "Our local bank personnel were very helpful in the project as well as supportive of the concept. We selected the bank as project trustee." A regional dairy cooperative reported that the only assistance it

needed with the financing was provided by the "local bank which purchased the bonds."

Local attorneys were also listed by six associations (four regionals and two locals) as assisting them with their ID bond financing. Both the locals and two of the regionals reported that the local attorney working with the local banker was all the help they needed in getting the financing. The other two regionals indicated assistance from investment bankers. A few cooperatives mentioned public accountants (or CPA's); local investment advisors also helped.

Method of Selling

The way the ID bond issue was placed or sold had much to do with the cost and time involved in getting the funds. If the cooperative could get the local banker to purchase the issue or other local financial institution and/or individuals to buy the bonds, the job became much easier and less expensive. Of course, all placements cannot be private⁴ because of the size of the issue and the market conditions prevailing at the time the bonds are to be sold.

Importance of Private Placement. — To find out how the 52 cooperatives marketed their bonds, the question was asked: "How have ID bond issues made to finance projects of your co-op been sold to investors?" Fifty-one associations reported that of the 149 issues involved, 99 (66 percent) were placed privately and 50 (34 percent) were sold by public placement.

ID bonds were marketed by offering them to one or a small number of buyers in about two out of three cases. One regional official contemplating going public with an issue stated: "This pollution control bond issue will probably be a public offering because of its size and the need for a broader marketing exposure to sell the issue at the lowest interest rate possible."

Use of Credit Rating Agencies. — Because of the predominance of private placement and frequent marketing of ID bonds locally to commercial banks and others, rating of the long-

⁴Issue is sold to a restricted number of investors but the SEC determines meaning of restricted which may vary among cases. However, if issuer and investors deal directly in arriving at terms of issue and if number of buyers to whom it is offered is small, the issue is normally a private placement.

term obligations appears unnecessary in most cases. To check the accuracy of this supposition, the question was raised: "Have any ID bond issues made to finance projects of your co-op been rated by Standard and Poor's, Moody's, Fitch, or other credit rating agencies?" Such a rating is sometimes obtained to make it easier to sell the bonds and at the lowest interest rate possible. The higher the rating the less risk to buyers and the more appealing the debt instruments become to potential investors.

Fifteen associations—11 regionals, 2 inter-regionals, and 2 locals—reported 37 ID bond issues had been rated by a credit agency. One local did not give the rater or rating received on a \$1.5-million issue used to finance a cheese plant. Thirty-seven cooperatives indicated no such ratings. Three co-ops reported 4 issues with AA (high grade) ratings, eight reported 24 issues with A (upper medium grade) including 1 with an A rating, and three reported 8 issues with BBB (medium grade) ratings including 2 with BBB+ ratings. The 113 unrated issues accounted for 60 percent of the total co-op ID bond capital.

Although only 37 (25 percent) of the 150 bond issues used to finance cooperative projects were rated, this number takes on added significance if we consider the dollar value it represents. Value of the 37 rated issues equaled \$105.5 million, which amounted to 40 percent of the \$265.1 million of total ID bond capital used by cooperatives.

Cost of Rating.—A farm supply regional cooperative, one of the financially strongest, received a single "A" Standard and Poor's (S&P) credit rating on the ID bonds it used. Its financial service manager stated: "The first issue of bonds rated cost us \$3,000 with following issues costing about \$1,500 each." A grain regional's controller whose cooperative had also received a single "A" rating on its ID bond issues said: "They charged us \$4,000 to rate the first issue and \$800 for each of the other issues."

Even though a cooperative's issues are not rated, this does not imply a lack of interest on the part of the buyer in the association's operations and soundness. For example, a farm supply regional's financial vice president indicated: "Our industrial revenue bonds have usually been sold to banks and individuals in the locations where we do business. However, we sold one

issue to a large insurance company which did a very thorough review of our cooperative."

Rated Issues Mostly "A" or "AA".—The fact that three-fourths of the 37 rated issues were in the "A" or "AA" class indicates the basic financial strength of the cooperatives involved. One of the three associations getting an "AA" rating was a local; the other two were regionals. S&P rated the issues of nine cooperatives; Fitch, four; and Moody's, two. The rater of one local was unknown. One farm supply regional had two large pollution control issues rated by both Moody's and S&P. They were in close agreement, with the former rating them "Baa" (equal to "BBB") and the latter "BBB+."

Of the 37 issues rated, 23 were public placements and 14 were private. The public issues ranged from \$4.5 million to \$460,000 with a median of \$1.7 million. The privately placed ones varied from \$17 million to \$225,000, with a median of \$2 million.

Who Buys the Bonds?

Local banks, insurance companies, and individuals purchased most of the ID bonds. The cooperatives were asked: "What type of investors purchased 'the largest single issue' of ID bonds used to finance one of your projects?"

Commercial banks were the largest buyers of ID bonds. They purchased about 36 percent—or \$27.6 million—of the 41 largest issues totaling \$77.6 million. In nine instances, involving the issues to be used by four locals and five regionals, commercial banks bought the total issue and parts of 21 other issues.

Individuals, comprised of farmers and others, were the next biggest investors. Their purchases amounted to \$21.6 million and accounted for nearly 28 percent of the 41 largest issues. Twenty-three cooperatives reported individuals as buyers of ID bonds and in four locals they were the only ones purchasing their largest issues.

The largest issue was the only issue of 15 of the 16 local cooperatives, with one local using two issues to finance separate projects. Individuals were the biggest purchasers of these 16 issues used by locals, accounting for 54 percent. Commercial banks took 44 percent and life insurance companies took the other 2 percent.

Eleven associations reported life insurance companies as one of the buyers of their largest issue, although these companies were not active in the purchase of ID bond issues used by local cooperatives. Two regionals indicated they were the only purchasers. Life insurance companies were the third largest buyers in that their purchases of \$18.6 million represented almost 24 percent of the total value of the cooperatives' 41 issues.

Commercial banks, individuals, and life insurance companies thus were the major buyers of ID bonds used by cooperatives, accounting for 87 percent of the total. Fourth in line were fire and casualty insurance companies which purchased \$8.9 million—equal to about 12 percent of the total dollar value of the issues. One interregional and five regionals reported this type of investor and one of each type sold their entire issue to a fire and casualty insurance company.

Local businesses and investment trusts or bond funds were minor market outlets for ID bonds. However, one regional reported selling 15 percent of a \$4.2-million issue (the largest one used to finance a project) to businesses in the area. Another regional specified as a type of investor “trust companies and unit investment trusts (bond funds)” which bought 10 percent of a \$2.2-million issue.

Bond Issue Costs

What it costs to issue ID bonds is a key consideration in deciding whether to use this source of long-term debt capital or some other means to finance a project. These costs should be included with the contract or coupon rate of interest on the bond issue to determine the effective interest rate over the life of the bonds. The amount of these front-end costs is affected by the way the issue is sold (whether privately or publicly, to one or a few buyers, or to many investors), size of the issue, its rating, if any, by a credit agency, and other factors.

The cooperatives, therefore, were asked: “What were the total bond issue costs connected with the ‘largest single issue’ used to finance a project?” and secondly: “What were the elements making up the bond issue costs of this largest issue?” Twenty-one regionals, 5 inter-regionals, and 13 locals responded.

Their largest issues totaled \$130.8 million and costs of issuing these ID bonds amounted to \$4.3 million. The median rate of cost of the 39 issues varied from 6.9 percent to 0.4 percent of the principal or face amount of the bonds. The median was 3.1 percent. Both the high- and low-cost issues were privately placed and much smaller than the \$1.75-million, median-sized largest one. Its issue cost of \$54,164 was the median rate (3.1 percent) of the 39 issues.

The median largest issue of the 39 associations was a \$1.75-million issue, floated in 1975 to finance a feed mill for a farm supply regional. It was placed publicly; life insurance companies purchased 53 percent of it and individuals purchased 47 percent. It was a serial issue with repayment of principal made in installments over 20 years with interest rates ranging from 6.75 to 7.875 percent, averaging 7.58 percent.

Total costs of the issue were \$54,164, comprised of commissions to bond seller, 56 percent; fees to a law firm providing bond counsel, 27 percent; fees to a CPA auditing firm, 15 percent; printing expenses, 1 percent; and trustee's fee, 1 percent. When these issue costs were annualized by prorating them over the bond's 20-year life, they added 0.15 percent to the average annual coupon rate of 7.58 percent, raising the total annual cost or effective interest rate on the bonds to 7.73 percent.

Locals.—Local co-op ID bond costs (\$324,000), as a percent of the principal or face value of the issue, were highest (4 percent) for the largest issues (totaling \$8.4 million) used by the 13 local associations. The median local issue, whose \$40,000 of bond issue costs equaled 4 percent of its \$1-million face value, was used by a local grain cooperative to finance a feed mill. The local reported that 88 percent of these costs went as commissions to a bond seller (underwriter), 10 percent as trustee's fees, and 2 percent as fees to a law firm providing bond counsel. The issue was placed privately with individuals buying 80 percent of it and commercial banks, 20 percent.

The smallest of the largest ID bond issues used by locals amounted to \$130,000 for financing a fertilizer blending plant. The local farm supply association reported \$4,905 (3.8 percent) of bond issue costs connected with this issue which was sold to commercial banks and indi-

viduals. The \$4,905 went to defray commissions to the bond seller and legal expenses.

A dairy local and a dairy regional reported the lowest bond issue costs amounting to 0.4 percent for each of their largest issues. A \$190,000 issue, used by the regional to finance its office building and milk testing facilities, cost \$800 to issue, with 90 percent of this amount going to pay legal expenses for preparing the lease agreement and other documents and 10 percent for trustee's fee. All of the issue was purchased by one local commercial bank and the services of a bond seller (underwriter) were not required to place the bonds.

The selling situation was similar with the local dairy cooperative whose \$975,000 issue to finance a milk cooler facility was placed without the services of an underwriter. Half of the issue was bought by commercial banks in the area and half by local individuals, with 80 percent of the \$4,000 bond issue costs going for legal fees to prepare contracts and agreements and the balance to cover printing expenses and trustee's fees.

Regionals. Bond issue costs (\$2.2 million) of the 21 regionals' largest issues (totaling \$67.6 million) showed the lowest median rate, 2.7 percent. This rate belonged to a \$2.2-million issue used by a farm supply regional to finance a fertilizer warehouse. The regional reported total issue costs of \$60,063 which consisted of commissions to underwriter, 64 percent; fees to bond counsel, 24 percent; costs of meeting State securities law requirements, 5 percent; trustee's fee, 4 percent; survey of property abstract, 2 percent; and printing expenses, 1 percent. The issue was publicly placed with commercial banks buying 35 percent of it, fire and casualty insurance companies, 30 percent; life insurance companies, 23 percent; bond funds, 10 percent; and individuals, 2 percent.

Interregionals. —The five interregionals reported bond issue costs of \$1.8 million on their largest issues totaling \$54.8 million. Median cost of the issues amounted to 3.2 percent of a \$26-million privately placed one used to acquire a public grain elevator. The \$26-million principal represented the sum of \$17-million and \$7-million term issues with 30- and 20-year lives, respectively, and a \$2-million serial issue coming due in installments over a 10-year period.

These three issues had the same date of issue and were handled as a single offering by the underwriter. Elements making up the total bond issue costs of \$827,003 on the \$26-million offering consisted of commissions to bond seller, 63 percent of total cost; fees to bond counsel, 17 percent; S&P rating, accounting and recording fees, 15 percent; printing expenses, 3 percent; and trustee's fee, 2 percent.

Time Required to Get Financing

Numerous parties and complex details involved in obtaining ID bond financing can contribute to time delays in gaining the needed funds. The cooperatives were asked: "How much time did it take to get the 'largest' issue you have used to finance a project authorized, approved and sold, and the bond proceeds delivered to the municipality or trustee?"

The largest number of the 50 associations responding indicated it took from 90 to 179 days to get this type of financing. These 22 associations consisted of 9 locals, 10 regionals, and 3 interregionals. The next largest number (made up of eight locals and seven regionals) reported 180 to 269 days involved in issuing and placing ID bonds.

Seven cooperatives reported getting the job done in less than 90 days and six indicated it took over 9 months. The executive vice president for one of the interregionals said they completed the arrangements for this financing in 45 days for the largest issue used. However, he stated that: "Generally speaking, it will take much longer to get this type of financing completed."

But the treasurer of a diversified regional which has used ID bonds to finance several projects remarked: "The 90 days was unusually long due to bond counsel's heavy schedule at the time; most issues have taken 45 days or less."

Is there any factor or phase in the process of getting ID bonds issued and sold which takes up the most time? The cooperatives were asked this question with reference to the largest issue they had used and 48 associations (23 regionals, 21 locals, and 4 interregionals) responded. A local replied that "no delay was out of line" and another (also a local), "all phases went quite smoothly."

Sixteen of the remaining 46 respondents (34.8 percent)—comprised of eight regionals, six locals, and two interregionals—listed preparation of legal documents as the factor taking up the most time in getting ID bond financing completed. One regional specified: “Getting bond counsel to prepare the documents took the most time.” Another said: “The documentation procedure is the most time consuming; however, this task is more difficult the first time the company goes public.”

Next in line was getting State approval of the ID bond issue. Of the 10 respondents (21.7 percent) indicating this item, 7 were locals, 2 were regionals, and 1 was an interregional. One regional whose largest issue was to finance a wastewater treatment facility said: “Obtaining final approval from the State Pollution Control Financing Authority took the most time.” Only about half the States require that projects financed with ID bonds be approved at the State level.

Eight associations (17.4 percent) indicated factors taking the most time were those connected with the approval by the municipal issuer. For example, the general counsel of one regional reported: “Statutory procedure requires formal action by the municipal board at three different meetings—the State board at two separate meetings and one court hearing. Delay is occasioned by the time required to intervene before formal action is taken and by the fact

that most municipal boards meet only once a month.” Moreover, the general manager of another regional stated: “The ID bond application could not be processed by the municipal issuer until land (just over one acre) was rezoned from residential to commercial. This required many public hearings before the zoning commission and county council lasting 5 or 6 months.”

Preparation of the official statement took the most time according to six cooperatives (13 percent), comprised of four regionals, one interregional, and one local. Four associations (8.7 percent) thought that placing the bonds required the greatest amount of time.

Getting approval from Bank for Cooperatives, delay caused by trustee bank and its attorney, meeting requirements of Environmental Protection Agency, obtaining title opinion on land, clearing lease with railroad, and securing rulings from Internal Revenue Service were various factors reported by single cooperatives as taking the most time. The financial vice president of a regional said: “The largest issue we have used (a \$12.7-million one for water pollution abatement) took approximately 2-1/2 years to get completed. A large part of this time was the result of securing rulings from the Internal Revenue Service. Where ID bond financing is used for pollution control, better cooperation from the IRS on rulings, where required, would be very helpful.”

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Appendix table 1—Results of mail screener survey to identify cooperatives with ID bond financed projects, responses received through March 1979

Commodity group	Population	Sample	Respondents	Percentage of population	
				Sample	Respondents
	Number of cooperatives			Percent	
Farm supply	2,731	2,216	1,975	81	72
Grain	1,986	1,719	1,501	90	76
Livestock	819	131	120	16	15
Dairy products	556	474	425	85	76
Cotton and cotton products	486	475	413	98	85
Fruit and vegetables	411	389	355	95	86
Wool and mohair	155	0	0	0	0
Service	146	0	0	0	0
Miscellaneous marketing	98	40	34	41	35
Rice	56	53	42	95	75
Poultry and poultry products	36	36	34	100	94
Tobacco	30	30	28	100	93
Nuts	15	15	14	100	93
Dry beans and peas	10	10	10	100	100
Total	17,535	25,666	4,950	75	66

¹Total number of cooperatives in United States based on 1975-76 survey of marketing, farm supply, and related services cooperatives as reported in Farmer Cooperative Research Report 3, March 1979.

²Most of the livestock shipping associations, wool pools, service co-ops, small dairy bargaining, and fruit and vegetable bargaining cooperatives and several patrons' associations and local cooperatives affiliated with certain regionals were excluded from the screener survey because of their nominal amount of assets.

Appendix table 2—Gross dollar volume frequency distribution for farmer marketing, farm supply, and related-service cooperatives, 1975-76

Volume group	Cooperatives		Volume	
	Number	Percent of total	Dollars ¹	Percent of total
Less than \$100,000	1,497	19.0	\$74,672,873	0.1
\$100,000-\$999,999	1,660	22.0	815,390,607	1.5
\$1 million-\$4.9 million	2,998	39.8	7,176,876,337	12.9
\$5 million-\$9.9 million	796	10.6	5,454,965,401	9.8
\$10 million-\$24.9 million	355	4.7	5,298,669,753	9.5
\$25 million-\$49.9 million	129	1.7	5,540,915,916	9.9
\$50 million-\$99.9 million	18	.2	1,574,236,311	2.8
\$100 million-\$199.9 million	34	.5	4,706,649,572	8.4
\$200 million-\$249.9 million	15	.2	3,474,438,022	6.2
\$250 million-\$499.9 million	18	.2	6,964,973,293	12.4
\$500 million-\$999.9 million	8	.1	5,404,670,912	9.7
\$1 billion and over	7	.1	9,378,834,258	16.8
Total	7,535	100.0	55,865,293,255	100.0

¹Gross amount, includes intercooperative volume.

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